MÜSİAD RESEARCH REPORTS - 17

THE TURKISH ECONOMY
1996

MÜSİAD

INDEPENDENT INDUSTRIALISTS AND BUSINESSMEN'S ASSOCIATION

MÜSİAD RESEARCH REPORTS-17

THE TURKISH ECONOMY 1996

July 1996

MÜSİAD
(INDEPENDENT INDUSTRIALISTS AND BUSINESSMEN'S ASSOCIATION)
Head Office: Mecidiye Cad. No: 7/50, Mecidiyeköy - 80310 İSTANBUL/TURKEY
Tel: (90.212) 267 40 37-38 – 274 12 66-67
Fax: (90.212) 267 49 41 – 288 39 43

This Report is Written by Dr. Adnan Büyükdeniz in coordination with the Resarch Commission of MÜSİAD.

About the Author

Born in 1958, Dr. Adnan Büyükdeniz received his B.A. Degree in Economics (1980) from the BOSPHORUS UNIVERSITY (İstanbul). Dr. Büyükdeniz pursued his post-graduate studies in England, and received Diploma (1981) and Master of Science (1982) degree in Economics from the LONDON SCHOOL OF ECONOMICS. Completing his PhD at the ISTANBUL UNIVERSITY (1980) in the field of Monetary Economics, Dr. Büyükdeniz is currently employed as a top level executive in a joint-venture financial institution in Turkey, and is also an economic advisor to MÜSİAD.

Dr. Büyükdeniz has a number of publications, and his book titled "The Interest Rate Policies in Turkey in the post 1980-era" was First Prize winner in the nationwide economics contest (1992) organized by the Turkish daily MİLLİYET.

ISBN 975-7215-09-0

Design: Birim (0212) 532 51 79

Printing: Eksen Matbaacılık

FOREWORD

Following the economic and financial crisis in 1994, the Turkish economy displayed a quicker-than-anticipated recovery during 1995, with the GNP growth reaching to as high as 8.1 percent for the year. Whilst the annual inflation rate remained around 75-80 pecent, the financial markets remained relatively stable. This achievement was largely due to the relative strength and dynamism of the Turkish private sector, relatively successful working of demand and supply force in the economy and to long-term potentials of the turkish economy. MÜSİAD believes that, Turkey with its considerable human and material resource and its tremendous entreprenurial capacity possesses a substantial potential for growth and stability in the future.

Unstable growth pattern of the economy together with the long existing high and variable inflation continues to stem mainly from basic imbalances and inefficiencies in the public sector. It is imperative that the new coalition government must show the political will and determination to take all necessary steps towards reducing and eliminating these imbalances and inefficiencies if Turkey is to resume sustainable growth within price stability. Economic policies must aim at strengthening the supply side of the economy through increased production, constant improvement in productivity and competitiveness, and removal of imperfections in the factor markets.

This report, based on the most recent figures, summarizes the main developments and trends observed in the Turkish economy since the beginning of 1995. It is the second report published by MUSIAD in English, with the objective of providing a reliable and objective reference of the Turkish economy for international circles taking interest in Turkey.

Hoping that this report would prove to be a useful reference about the recent trends and near fuure prospects of the Turkish economy, MÜSİAD plans to continue conducting studies on the critical economic and social topic, in addition to its periodic reports on the Turkish economy.

Yours Faithfully,

EROL YARAR
President, MÜSİAD

CONTENTS

TABLES

SUMMARY

Following a considerable contraction in the previous year, in 1995, the Turkish economy experienced a higher-then-expected economic growth. Gross National Product grew by 8.1 percent as against the targeted 4.4 percent growth. In 1995, gross fixed investment expenditure increased by around 8.3 percent in real terms. Whilst private fixed investment was up by 14.9 percent, public fixed investment declined by 16.9 percent in real terms. The open unemployment rate declined from 7.9 percent in 1994 to 6.6 percent in 1995, whilst the underemployment rate displayed a similar trend declining from 8.7 percent in 1994 to 6.3 percent in 1995.

Resultant partly from the government's expansionary fiscal policies, the targeted budget deficit (TL 218.8 trillion) was exceeded by a substantial margin reaching to around TL 319.4 trillion for the year. The higher-than-projected budget deficit was mainly due to the fast increase in interest payments on public domestic debt stock, whilst the decline in real public investment expenditure continued also in 1995.

In 1995, the government continued to rely on short-term borrowing in financing its budget cash deficit and in re-financing the maturing debt stock. The government materialized a net borrowing of TL 297 trillion as against the targeted TL 198 trillion, consisting mainly of short term T-bills, partly of Central Bank Advances to the Treasury. There was a net decline in net foreign borrowing in financing requirement of the public sector, as was targeted in the 1995 programme.

The realization estimates indicate that, the State Economic Enterprises performed even better than initially projected by the 1995 programme, reducing their operating losses and borrowing requirement.

The fast growth of public domestic debt stock continued also during 1995. Whilst the domestic debt stock did not increase in real terms, it was not possible to lengthen the average maturity of the existing debt stock. The domestic debt stock has risen by around 54 percent in the first four months of 1994 which, given the inflation during this period, meant a real increase in the debt stock. As of end of April 1996, the total domestic debt stock has reached to around TL 2,100 trillion.

The Turkish monetary authorities had initially aimed at following a tight monetary stance during 1995; accordingly, the Central Bank would achieve monetary control in the economy mainly through the control of domestic credit expansion, particularly through the control of Central Bank Advances to the Treasury. Whilst the monetary authorities were considerably successful in limiting domestic credit expansion, this could not prevent the high rate of monetary expansion during 1995. An analysis of the analytical balance of the Central Bank indicates that, the major difficulty faced by the monetary authorities in achieving the desired degree of monetary control was the high rate of growth of Central Bank net foreign assets, mainly due to faster-than-expected growth of official international reserves. The Central Bank foreign exchange reserves which stood at 6 billion US Dollars at the end of 1994, increased to as high as 16 billion US Dollars by the end of 1995, resultant partly from reversal of "currency substitution (increased preference towards the local currency) and partly from large influx of short-term foreign capital funds in response to substantial differential between domestic and foreign interest rates.

In 1995, the banknote issue increased by around 86 percent as compared to 90.5 percent in the previous year. The rate of increase in the banknote issue has been considerably slower in the first four months of 1996 as compared to the corresponding period of the previous year. However, the monetary expansion during the first half of 1996, whilst being at a raletively slower rate as compared to the previous year, appears to validate an inflation rate of not lower than 80 percent for the year.

The total consolidated commercial bank deposits grew by 100 percent in 1995, indicating to a real growth in bank deposits. The share of foreign currency deposits remained around 50 percent, suggestive of relatively strong preference of financial savings towards foreign currency. Total TL deposits displayed a slightly lower rate of growth (32 percent) in the first four and a half months of 1996 as compared to the corresponding period of the previous year, indicating to some real decline in bank deposits.

In 1995, credits extended by the commercial banks displayed a considerably high real growth, short term credits extended to the business sector growing by around 150 percent in nominal terms. The demand for commercial bank credits was weaker in the first half of 1996, such credits growing by only around 30 percent. In 1995, resultant from relatively successful control of the Central Bank's advances to the public sector, particularly in the form of short term advances to the Treasury, Central Bank direct credits grew at a considerably slower rate, by around 31 percent. The Central bank seems to follow a somewhat looser credit policy towards the public sector in the first half of 1996; as a result, direct credits extended by the Central Bank grew by around 30 percent in the first four and a half months of 1996.

In 1995, the local capital market was influenced both by the heavy public domestic borrowing requirement and political uncertainties. The Istanbul Stock Exchange could not achieve the widely expected sharp rise in the index and in the trading volume. The ISE composite index was up by around 55 percent increase in the first five months of 1995. The industrial and financial indices rose by around 50 percent and 76 percent, respectively.

In 1995, the local market interest rates continued to be determined to a great extent by the borrowing requirements of the public sector. Despite the declining trend of interest rates since 1995, the growing domestic debt stock and its financing mainly from the local market, shall determine the future course of interest rates during the remaining part of 1996.

The annual inflation rate as measured by the Consumer Price Index, decelerated from 125.5 percent at the end of 1994, to 76 percent by December 1995. Demand-side factors have played a relatively greater role than supply-side (cost) factors, in determining inflation. The decelerating trend of inflation during 1995, seems to have reversed since the beginning of 1996; the annual inflation rate is highly likely to stay within 80-85 percent band.

In 1995, total imports increased by around 55 percent against the 19.5 percent incrase in exports. As result, the trade deficit recorded a sharp rise in 1995 reaching to its 1993 level. The relative deterioration in the current account did not howover lead to any major difficulty in the balance of payments, thanks to substantial improvement in the capital account.

The 1996 programme account projects a 3.8 billion US dollars deficit in the current account. However, given the first six month trends in the trade account, the current account ca be expected to yield a higher-than projected deficit in the current year. The rise in Central Bank foreign exchange reserves continued into the first half of 1996, the reserves rising to as high as 15 billion US dollars. Various indicators of external debts suggest that, in 1995, there was a relative improvement in Turkey's foreign indebtedness.

CHAPTER 1

GROSS NATIONAL PRODUCT, INVESTMENT ACTIVITY AND LABOUR MARKET

I. MACROEQUILIBRIUM OF THE ECONOMY

The Turkish economy which had displayed a considerable contraction in 1994, experienced a higher-than-projected real growth in 1995. The 1995 Economic Programme, based on the assumptions of a 5 percent growth in real effective aggregate demand, average inflation rate of 43% and some 430 million US Dollars surplus in the current account, en-

TABLE: 1 MACROEQULIBRIUM OF THE ECONOMY (At Current Prices)

	1995 (BILLION TL)	Percentage share (%)	Percentage Growth Nominal	Percentage Growth Real
I. PRIVATE FINAL CONSUMPTION	5,399,506	70.4	110.5	7.6
II. PUBLIC FINAL CONSUMPTION	837,243	10.9	85.7	6.7
III. GROSS FIXED CAPITAL FORMATION	1,786,276	23.3	88.8	8.3
PUBLIC	290,172	16.2	39.7	-16.9
PRIVATE	1,496,104	83.8	102.6	14.9
IV. CHANGES IN INVENTORY	3,834		–	–
V. EXPORTS OF GOODS/SERVICES	1,532,382	20.0	85.4	6.7
VI. IMPORTS OF GOODS/SERVICES	1,888,011	24.6	138.4	30.0
GROSS DOMESTIC PRODUCT	7,671,230	100.0	97.8	7.5
Statistical Discrepancy	-116,472	–	–	–
GROSS DOMESTIC PRODUCT(1)	**7,554,758**	–	**95.3**	**7.3**

(1) Expenditures on the Gross Domestic Product

visaged a 4.2 percent growth in Gross Domestic Product (GDP) and 4.4 percent growth in Gross National Product (GNP). Accordingly; agricultural output would grow by 2.5 percent, industrial output by 4.9 percent and services output by 4.3 percent.

According to the State Planning Offices estimates; private final consumption, having declined by around 5.4 percent in 1994, recorded a higher-than-projected growth in 1995. Private final consumption increased by around 110 percent in nominal and 7.6 percent in real terms. As a result of expansionary fiscal policies; especially in the latter half of the year, public final consumption increased by 85 percent in nominal and 6.7 percent in real terms.

The SPO's estimates indicate to a real growth in private investment expenditures and a real decline in public investment expenditures. Private investment expenditure increased by 14.9 percent in real terms whilst there was a 16.9 percent decline in real public invest-

TABLE: 2 GROSS NATIONAL PRODUCT(1) (At Current Producers' Prices)

SECTOR	1995 VALUE (BILLION TL)	NOMINAL GROWTH RATE (%)
AGRICULTURE	1,134,566	29.7
INDUSTRY	2,042,395	100.3
Mining	98,545	82.2
Manufacturing	1,751,681	105.2
Energy	192,168	71.3
CONSTRUCTION	426,215	61.6
TRADE	1,550,148	103.3
TRANSPORTATION/COMMUNICATION	970,931	88.9
FINANCIAL INSTITUTIONS	254,557	121.3
OWNERSHIP OF DWELLING	249,169	94.8
BUSINESS AND PERSONAL SERVICES	278,627	95.1
(-) IMPLICIT BANK SERVICE CHARGES	270,344	65.4
GOVERNMENT SERVICES	619,784	79.9
PRIVATE NON-PROFIT INSTITUTIONS	14,376	60.3
IMPORT DUTIES	284,130	109.3
GROSS DOMESTIC PRODUCT (in purchaser's prices)	**7,554,758**	**95.3**
NET FACTORS INCOMES FROM ABROAD	19,448	
GROSS NATIONAL PRODUCT	**7,644,206**	**96.6**

(1) The new GNP series
SOURCE: STATE INSTITUTE OF STATISTICS

ment expenditure. Increased importance of transfer expenditures in the government budget, consisting mainly of interest expenditures on public domestic and foreign debt stock, has been a major reason for the real decline in real public investment expenditures in recent years.

II. GNP PERFORMANCE

According to the provisional estimates of the State Institute of Statistics, in 1995, the Turkish economy grew at a considerably higher rate than initially expected, recording a real GNP growth of 8.1 percent (as against minus 6 percent growth in the previous year). The high GNP growth stemmed mainly from expansion of domestic aggregate demand rather than net foreign demand on domestic output.

Agricultural output grew by 2.6 percent in 1995, which compares favourably with minus 0.3 percent growth in 1994 and minus 1.3 percent growth in 1993.

Industrial sector, on the other hand, recorded a considerably high growth performance, the industrial output growing by around 12.1 percent as against the previous year's 5.7 percent minus growth and 8.2 percent positive growth in 1993.

TABLE: 3 GNP GROWTH RATE (At 1987 Producers' Prices) % Change

	1995	1994	1993	Percentage Share (1995)
AGRICULTURE	2.6	-0.3	-1.3	14.9
INDUSTRY	12.1	-5.7	8.2	28.0
CONSTRUCTION	-4.7	-2.0	7.9	5.9
TRADE	11.6	-7.5	11.6	20.1
TRANSPORTATION/ COMMUNICATION	5.9	-2.0	10.8	12.6
FINANCIAL INSTITUTIONS	0.4	-1.5	-0.4	2.4
OWNERSHIP OF DWELLING	2.3	2.8	2.8	5.3
BUSINESS AND PERSONAL SERVICES	7.0	-4.2	6.9	2.3
(-) IMPLICIT BANK SERVICE CHARGES	0.1	-1.8	-0.6	2.1
GOVERNMENT SERVICES	2.5	0.8	1.8	4.5
PRIVATE NON-PROFIT INST.	-1.3	-2.5	3.0	0.4
IMPORT DUTIES	11.8	-35.2	32.8	3.9
GROSS DOMESTIC PRODUCT	7.3	-5.4	8.0	98.9
NET FACTOR INCOMES **FROM ABROAD**	173.4	-61.0	14.6	1.1
GROSS NATIONAL PRODUCT	8.1	-6.0	8.1	100.0

Construction sector which traditionally plays on important role in yearly GNP performance, recorded a minus 4.7 percent growth in 1995, as against the 7.9 percent growth achieved in 1993.

Trade sector grew by 11.6 percent in 1995, whilst the growth in business and personal services was 7 percent.

Gross Domestic Product (GDP) grew by 7.3 percent in 1995, as against minus 5.4 percent growth in the previous year. As a result of 173 percent growth in net factor incomes from abroad, Gross National Product grew by 8.1 percent as against the targeted 4.4 percent growth for the year.

Industrial output recorded an average growth of 6.1 percent in the first four months of 1996, as compared to no growth in the corresponding period of 1995. The annual growth of industrialy production as of April 1996 was minus 1.6 percent.

Capacity utilization rate in manufacturing industry, having reached to its peak in September 1996 (84 percent), declined to 76.1 percent by April 1996, but picked up to 83 percent in May. Manufacturing output was up by around 5.4 percent on average in the first four months of 1996, whilst the annual growth in manufacturing output was minus 3.0 percent as of April 1996.

According to the statistics disclosed by the State Institute of Statistics, the Turkish economy recorded a considerably high economic growth in the first guarter of 1996. As a result of 2.8 percent growth in agriculture, 8.8 percent growth in industry and 12.6 percent growth in industry and 12.6 percent growth in trade sector, Gross Domestic Product grew by 8.2 percent in the first quarter, The GNP growth accelerated from 7.7 percent in the last quarter of 1995, to 9.9 percent in the first quarter of 1996.

TABLE: 4 CAPACITY UTILIZATION RATE IN MANUFACTURING INDUSTRY (Percentage)

	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
1995	74.7	73.2	74.6	78.9	79.4	81.5	83.4	82.6	84.3	80.7	79.4	81.4
1996	79.7	78.1	75.2	76.1	83.0							

SOURCE: SIS

TABLE: 5 INDUSTRIAL PRODUCTION(1)

(As of April)

	Percentage Change With Respect to the same month of previous year		First 4 months average	
	1996	1995	1996	1995
a) Manufacturing Industry	-3.0	15.0	5.4	-0.9
b) Mining	-4.2	-4.6	1.8	-2.2
c) Electiricity-Gas-Water	9.2	12.0	12.2	7.9
TOTAL INDUSTRIAL PRODUCTION	-1.6	13.6	6.1	0.0

(1) Percentage change in industrial production index

TABLE: 6 INDUSTRIAL PRODUCTION INDEX (1992= 100)

	MANUFACTURING INDUSTRY		INDUSTRY TOTAL	
	1996	1995	1996	1995
JAN.	108.7	96.7	111.8	99.7
FEB.	88.6	88.0	92.4	90.8
MARCH	104.1	93.0	107.7	95.2
APR.	100.6	103.7	102.8	104.5
MAY		97.8		98.5
JUNE		109.4		110.6
JULY		105.7		108.7
AUG.		107.9		111.0
SEPT.		111.4		113.1
OCT.		112.8		113.4
NOV.		122.3		123.5
DEC.		121.8		124.3

SOURCE: The SIS

III. INVESTMENTS

In 1995, gross fixed investment expenditure increased by around 8.3 percent in real terms. Whilst private fixed investment was up by 14.9 percent, public fixed investment declined by 16.9 percent in real terms. The ratio of private fixed investment to GNP has risen from 17 percent in 1994, to 19.8 percent in 1995 whilst the ratio of public fixed investment to GNP declined to 3.8 percent, from around 5 percent in the previous year.

In the first quarter of 1996, a total of 1071 investment incentive certificates amounting to TL 373.4 trillion, were issued. When compared to the corresponding period of 1995, this represents a 300 percent increase in the amount of investments under incentive scheme. A major portion of the investment incentive certificates received are related to completely new investment projects. Investment in manufacturing industry takes the largest share (TL 228.4 trillion), followed by services (TL 104.3 trillion), energy (TL 22.8 trillion) and agriculture (TL 13.8 trillion).

TABLE: 7 INVESTMENT EXPENDITURE (1995)

	VALUE, BILLION TL (Current Prices)	PERCENTAGE CHANGE	
		NOMINAL	REAL
GROSS FIXED CAPITAL FORMATION	1,786,276	88.8	8.3
I. PUBLIC SECTOR	290,172	39.7	-16.9
Machinery/Equipment	71,683	78.7	3.2
Building Construction	66,469	73.1	4.2
Other Construction	150,020	17.2	-30.5
II. PRIVATE SECTOR	1,496,104	102.6	14.9
Machinery/Equipment	751,863	136.5	28.1
Building Construction	133,243	71.6	2.1
Other Construction	610,998	76.1	3.2
GROSS FIXED CAPITAL FORMATION/GDP	23.6		
PUBLIC INVESTMENT EXPENDITURE/GDP	3.8		
PRIVATE INVESTMENT EXPENDITURE/GDP	19.8		

TABLE: 8 INVESTMENT INCENTIVE CERTIFICATES (ISSUED) (JANUARY-MARCH 1996)

	NO. OF CERTIFICATES	TOTAL INVESTMENT (BILLION TL)	FIXED CAPITAL INVESTMENT (BILLION TL)	EXPECTED ADDITIONAL EMPLOYMENT (Persons)
BY SECTOR				
-AGRICULTURE	28	13,782	12,039	1,521
-MINING	29	4,059	3,906	1,300
-MANUFACTURING				
-INDUSTRY	606	228,366	218,315	36,733
-ENERGY	11	22,959	22,207	176
-SERVICES	397	104,268	103,602	18,205
TOTAL	1071	373,435	360,071	57,483

IV. THE LABOUR MARKET

The 1995 Economic Programme had envisaged some decline in unemployment parallel to 4-4.5 percent economic growth targeted for the year.

The SIS statistics indicate that, the open unemployment rate declined from 7.9 percent in October 1994, to 6.6 percent in October 1995, whilst the underemployment rate displaying a similar trend, declining from 8.7 percent in 1994 to 6.3 percent in 1995. It appears that, the unemployment rate declined at a faster rate than projected in the Economic Programme, mainly due to high economic growth achieved in 1995.

As of October 1995, agricultural employment accounted around 48 percent of total employment, followed by services employment (31.5 percent) and industrial employment (20.7 percent).

TABLE: 9 THE LABOUR MARKET (Thousand Persons)

	OCTOBER 1995	OCTOBER 1994	OCTOBER 1993
SUPPLY OF LABOUR	22,900	22,136	21,628
Urban	10,247	10,214	9,882
Rural	12,653	11,922	11,746
EMPLOYMENT	21,378	20,833	19,906
Urban	9,220	8,932	8,693
Rural	12,158	11,901	11,213
UNEMPLOYMENT	1,522	1,740	1,722
Urban	1,027	1,134	1,189
Rural	495	606	533
UNDEREMPLOYMENT	1,450	1,931	1,570
Urban	643	906	757
Rural	807	1,025	813
UNEMPLOYMENT RATE (%)	6.6	7.9	8.0
Urban	10.0	11.1	4.5
Rural	3.9	5.1	7.3
UNDEREMPLOYMENT RATE (%)	6.3	8.7	7.3
Urban	6.3	8.9	7.7
Rural	6.4	8.6	6.9
LABOUR PARTICIPATION RATE (%)	50.8	50.4	50.3
Urban	41.3	42.7	42.6
Rural	62.5	59.6	59.4

SOURCE: The State Institute of Statistics

Whilst open unemployment is comparably higher in urban areas (around 10 percent as against 3.9 percent open rural unemployment), underemployment rate appears to be similar in both rural and urban areas (around 6.3-6.4 percent) suggesting high disguised unemployment in rural areas.

TABLE: 10 DISTRIBUTION OF EMPLOYMENT BY SECTOR (Percentage Distribution)

	OCTOBER 1995	OCTOBER 1994	OCTOBER 1993
AGRICULTURE	47.8	44.2	43.4
INDUSTRY	20.7	21.9	22.4
Manufacturing	13.8	14.6	15.1
SERVICES	31.5	33.8	34.2
TOTAL	100.0	100.0	100.0

SOURCE: The State Institute of Statistics

CHAPTER 2

PUBLIC FINANCE AND DOMESTIC DEBT

I. CONSOLIDATED BUDGET

The 1995, revised budget had envisaged a 83 percent increase in public budget expenditure whilst public budget revenues were planned to increase by around 78 percent. Accordingly; the consolidated budget deficit would materalize at around TL 218.8 trillion,

TABLE: 11 CONSOLIDATED BUDGET (Current Prices, Billion TL)

	1995 PROGRAMME	1995 REALIZATION(1)	1996 REVISED PROGRAMME	PERCENTAGE CHANGE 1996/1995
EXPENDITURE	1,331,000	1,696,595	3,450,000	103.3
a) Current	585.000	640,468	1,180,000	84.2
Personnel	460,000	502,724	880,000	75.0
Other	125,000	137,744	300,000	117.8
b) Investment	88,500	88,164	200,000	126.8
c) Transfer	657,500	967,963	2,070,000	113.9
REVENUE	1,133,000	1,377,124	2,650,000	92.4
a) General Budget	1,127,000	1,371,344	2,640,000	92.5
Tax Revenue	880,000	1,085,415	2,073,000	91.0
Non-Tax Revenue	74,000	79,016	240,000	203.7
Special Revenue and Funds	173,000	206,913	327,000	58.0
b) Annexed Budget	6,000	5,780	10,000	73.0
BUDGET DEFICIT	-198,000	-319,471	-800,000	150.4

(1) Provisional

whilst the ratio of budget deficit to GNP and the ratio of PSBR to GNP would decline to 3.2 percent and 5.6 percent, respectively.

Contrary to what was initially targeted, the government pursued an expansionary fiscal policy in 1995, partly as a result of election economics during the latter half of the year. As a result, the consolidated budget expenditure target was exceeded by around 27.5 percent, reaching to TL 1,696.5 trillion. Whilst the current expenditure, consisting mainly of personnel expenditure, deviated by around 9 percent from the revised target, investment expenditure fell below the target resulting in a considereble decline in real public investment spending. The substantial deviation in budget expenditure resulted mainly from larger-than-planned increase in transfer expenditure (by around 22 percent) consisting mainly of interest payments on domestic and foreign debt. In 1995, whilst the average interest rate payable on public domestic borrowing was on a declining trend, it was not possible to achieve a substantial decline in interest rates, and the real interest rate remaining strongly positive also during the year. As in recent years, the continually rising share of public interest expenditure was at the expense of declining share of public investment spending, bringing the share of public investment spending below 10 percent in total budget spending.

TABLE: 12 CONSOLIDATED BUDGET (Cumulative, Billion TL)

	JANUARY-APRIL		PERCENTAGE CHANGE
	1996	1995	
REVENUE	592,181	342,235	73.0
-Tax Revenue	468,160	258,743	80.9
-Non-Tax Revenue	28,678	19,701	45.6
-Special Revenue and Funds	82,026	56,341	45.6
-Annex Budget	13,317	7,450	78.8
EXPENDITURE	630,837	470,531	34.1
-Personnel	261,673	134,742	94.2
-Other Current Expenditure	30,957	17,224	79.7
-Investment	17,295	10,785	60.4
-Transfer	320,912	307,780	4.3
a) Interest Payments	138,183	194,145	-28.8
b) Tranfers to SEEs	12,276	9,929	23.6
c) Other Transfers	170,453	103,706	64.4
BUDGET BALANCE	-38,656	-128,296	-69.9
CASH BALANCE	-431,301	-140,750	206.4

The consolidated budget revenue, on the other hand, exceeded the target by around 21.5 percent, reaching to TL 1,133 trillion. The tax revenue displayed a 84.5 percent increase in 1995, whilst the increase in non-tax revenue was around 60 percent. The annex budget revenue declined by 38 percent.

As a result, the targeted budget deficit (initially TL 198 billion) was exceeded by a substantial margin (around 60 percent), reaching to around TL 319.4 trillion for the year. Again, the substantial deviation in budget deficit target stemmed mainly from rapid growth of interest payment on government domestic debt stock.

Again in 1995, the government relied on short-term borrowing (T-bills with short maturities) in financing its budget cash deficit and in refinancing maturing debt stock. Whilst the government had initially targeted a net borrowing of around TL 198 trillion for the year, this target was exceeded by a substantial margin (by around 50 percent), with net borrowing for 1995 reaching to around TL 297 trillion.

The 1996 Economic Programme targeted a 103.3 percent nominal increase in consolidated budget expenditure and a 92.4 percent increase in budget revenue. Accordingly, the targeted budget deficit is TL 800 trillion, meaning a 150 percent increase in budget deficit over the previous year.

It is observed that, the consolidated budget revenue showed a 73 percent increase in the first four months of 1996 as compared to the corresponding period of the previous year. The tax revenue was up by around 81 percent in the first four months of 1996, whilst non-tax revenue and special revenue/funds each showed a 45 percent increase. The consolidated budget expenditure increased by around 34 percent in the first four months. Whilst the consolidated budget deficit stood at TL 38.6 trillion (as against the previous year's TL 128.3 trillion) in the first four months, there was a substantial increase in cash deficit (over 200 percent), reaching to around TL 431.3 trillion as against TL 140.7 trillion in the corresponding period of the previous year. It appears that, if the budget trends observed in the first half of 1996 continues into the latter half of the year, the targeted budget deficit shall be exceeded by a substantial margin, not being less than TL 800 trillion.

II. FINANCING OF BUDGET DEFICIT

The 1995 Programme had targeted a greater reliance on longer term domestic borrowing, and reduced foreign borrowing and short-term domestic borrowing (including Central Bank short-term advances) in meeting financing requirement of the public sector. In fact, the government's debt management developed in the targeted direction in the first three or four months of the year, with the resultant re-financing of maturing debt stock through relatively longer term (e.g. one-year) borrowing and gradual decline in interest cost on public domestic borrowing. However, the relative improvement in public debt management has grown to be short-lived and the public sector was again back to "short-term, high cost domestic borrowing", with increased reliance on Central Bank short-term advances and Treasury bills. In 1995, there was a net decline in foreign borrowing.

TABLE:13 FINANCING OF CONSOLIDATED BUDGET CASH DEFICIT (Billion TL)

	JANUARY-APRIL	
	1996	1995
CASH DEFICIT	-431,301	-140,750
FINANCING	431,301	140,750
-Government Bonds	-146,068	95,596
-Treasury Bills	649,677	52,673
-Central Bank Advances	56,670	33.912
-Foreign Borrowing	-56,423	-38.849
-Other	-72,555	-2.582

TABLE: 14 PUBLIC DEBT MANAGEMENT (Current Prices, Billion TL)

	1996 REVISED TARGET	1995 TARGET(1)	REALIZATION
DEBT REPAYMENT	3,014,400	840,398	1,325,780
a) Foreign Debt	406,700	186,153	238,153
b) Domestic Debt:			
Gov't Bonds	290,600	61,400	136,796
Treasury Bills	2,317,100	592,845	950,000
BORROWING	3,814,400	1,038,398	1,622,931
a) Foreign Debt	233,700	141,272	157,746
b) Domestic Debt:	3,580,700	897,126	1,464,376
-Gov't Bonds	460,200	234,833	222,453
-Treasury Bills	2,946,500	618,693	1,147,200
-Central Bank Advances (net)	174,000	43,600	94,723
c) Other	-	-	809
NET BORROWING	800,000	198,000	297,151

(1) Provisional

The government continues to rely on short-term sources in meeting its financing requirements; in the first four months of 1996, the cash deficit was financed mainly by short-term Treasury bills.

III. STATE ECONOMIC ENTERPRISES

The 1995 Programme projected a better financial performance for the State Economic Enterprises. Accordingly; the ratio of SEE's borrowing requirement (including the budget transfer) to GNP would decline to 1.5 percent Similarly, the ratio of SEE's borrowing requirement (excluding the budget transfer) would decline to 1.9 percent. The realization estimates indicate that, the SEE's financially performed even better than initially projected by the Programme, reducing their operating losses and borrowing requirement. The total revenue generated by the SEEs increased by around 39 percent in 1995, whilst the increase in total expenditure was 35 percent; as a result, the deficit incurred by the SEEs declined from TL 47.2 trillion in the previous year, to TL 37.6 trillion in 1995.

TABLE: 15 STATE ECONOMIC ENTERPRISES (BILLION TL)

	1996(2)	1995(1)	1994
I. REVENUE	1,573,296	947,022	681,597
II. EXPENDITURE	1,675,481	984,648	728,851
a) Operating Expenses	1,367,274	836,895	638,770
b) Investment Expenditures	139,860	65,538	45,812
(II-I) DEFICIT (BORROWING REQUIREMENT)	-102,185	-37,626	-47,254
FINANCING:	102,185	37,626	47,254
a) Net Domestic Borrowing	121,443	60,145	63,789
b) Net Foreign Borrowing	-6,507	-16,580	-5,010

(1) Realization estimate
(2) Revised target

The 1996 programme targets a 66 percent increase in the SEE's revenue against 70 percent increase in expenditure. The SEEs are expected to increase their investment spending by around 113 percent. Whilst the programme projects SEE's deficit to increase by 170 percent, this deficit is planned to be financed entirely by domestic borrowing, whilst the net foreign indebtedness of the SEEs is expected to decline.

IV. PUBLIC DOMESTIC BORROWING AND DEBT STOCK

The net public domestic debt stock has risen from TL 799.3 trillion at the end of 1994, to around TL 1,361 trillion by December 1995, meaning a 70 percent increase in nominal terms. Whilst the domestic debt stock did not increase in real terms, it was not possible to lengthen the average maturity of the existing debt stock.

TABLE: 16 PUBLIC DOMESTIC BORROWING (BILLION TL)

	APRIL1996	1995	1994
DOMESTIC DEBT STOCK	2,093,774	1,361,007	799,310
a) Government Bonds	555,916	511,769	239,385
Exchange Difference	40	25,940	133,417
b) Treasury Bills	1,289,148	631,298	304,230
c) Central Bank			
Advances to Treasury	248,670	192,000	122,278

The government still continues to pay considerebly high positive real interest rate on its domestic borrowing. Whilst the average interest rate payable on public domestic borrowing followed a declining trend during 1995, this trend seems to have reversed in the second quarter of 1996. In view of the government's huge borrowing requirement during 1996, the real interest rate payable on domestic borrowing is highly likely to remain strongly positive during latter half of the year. As a result of growing interest burden, the ratio of real interest payment on public domestic debt to national income has risen from 2.64 percent in 1992, to 5.63 percent in 1995.

TABLE : 17 NOMINAL AND REAL INTEREST RATE ON PUBLIC DOMESTIC BORROWING (Percentage)

	INTEREST RATE(1)	
	NOMINAL	REAL(2)
1990	58.90	4.3
1991	72.99	11.3
1992	77.83	9.7
1993	89.23	19.5
1994	139.0	8.3
1995	108.0	10.3

(1) Interest payable on one-year government bonds

(2) Nominal interest rate deflated by the SIS's wholesale price index.

The rapid growth of public domestic debt stock continued also into the first half of 1996. The domestic debt stock has risen by around 54 percent in the first four months of 1996, which, given the inflation rate during this period, meant a real increase in the debt stock. As of end of April 1996, the total domestic debt stock has reached to around TL 2,100 trillion.

TABLE: 18 INTEREST PAYMENT ON PUBLIC DOMESTIC DEBT AND NATIONAL INCOME

YEARS	INTEREST PAYMENT (BILLION TL)		INDEX OF REAL INTEREST PAYMENT	RATIO OF REAL INTEREST PAYMENT TO REAL NATIONAL INCOME(%)
	NOMINAL	REAL[1]	(1987=100)	
1987	1,260	1,260.0	100.0	1.68
1988	3,159	1,818.6	144.3	2.39
1989	5,115	1,803.6	143.1	2.33
1990	9,613	2,114.6	167.8	2.50
1991	16,941	2,245.6	178.2	2.64
1992	30,545	2,380.7	188.9	2.64
1993	92,518	4,341.0	344.5	4.44
1994	233,168	5,304.2	420.9	5.78
1995	475,519[2]	5,586.6	443.4	5.63

(1) At 1987 constant prices, nominal interest payment deflated by the consumer price Index.
(2) provisional

CHAPTER 3

MONETARY TRENDS

I. THE MONETARY POLICY

With the objective of achieving a lower rate of inflation, the Turkish monetary authorities had initially aimed at following a tight monetary stance during 1995. Accordingly; the Central Bank would try to achieve monetary control in the economy mainly through the control of domestic credit expansion, particularly through the control of Central Bank advances to the Treasury.

Central Bank credits to public and private sectors grew a considerably lower rate, by around 28 percent, in 1995, implying that the monetary authorities were relatively successful in limiting domestic credit expansion to levels consistent with lower rates of monetary expansion. However, the considerably slower growth of Central Bank domestic credits could not prevent high rate of monetary expansion. Various indicators of monetary expansion, such as the reserve money, the Central Bank money, the size of the Central Bank balance sheet show that, it was not possible to achieve the degree of monetary control consistent with the targeted rate of inflation, also in 1995. A study of the analytical balance sheet of the Central Bank indicates that, the major difficulty faced by the monetary authorities in achieving the desired degree of monetary control was the high rate of growth of Central Bank net foreign assets, mainly due to excessive growth of official international reserves. The Central Bank's international reserves which stood at 6 billion US Dollars at the end of 1994, increased to as high as US Dollars 16 billion by the end of 1995, resul-

TABLE: 19 SOME MONETARY AGGREGATES

	BILLION TL			JAN-MAY PERCENTAGE CHANGE		PERCENTAGE CHANGE	
	MAY 3	DEC 29	DEC 30				
	1996	1995	1994	1996	1995	1995	1994
Banknotes Issued	285,346	223,934	120,212	27.4	68.5	86.3	90.5
Reserve Money	426,775	343,484	185,736	24.2	61.7	84.9	82.5
Central Bank Total Credits	266,700	206,126	160,431	29.4	25.3	28.5	59.5
-Public	254,502	193,877	148,108	31.3	27.4	30.9	78.6
-Private	12,198	12,249	12,322	-0.4	-0.2	-0.5	-30.0
M1 MONEY SUPPLY	480,805	396,047	238,981	21.4	28.4	66.1	80.0
M2 MONEY SUPPLY	1,610,850	1,270,423	642,490	26.8	39.2	97.7	120.0
M1/Reserve Money (%)	112.7	115.3	64.7				
M2/Reserve Money (%)	377.4	369.9	345.9				
M1/GNP(1) (%)	-	5.2	6.1				
M2/GNP(1) (%)	-	16.6	16.5				

(1) Based on the new GNP series.

tant partly from the reversal of "currency substitution" (increased preference towards local currency) and partly from large influx of short-term foreign capital funds in response to considerable interest rate differentials.

The actual trends followed by the exchange rate and the inflation rate during the period between 1988-1995 suggest that, with the exception of 1994, the Turkish policy makers have basically adapted a "nominal anchor" approach to exchange rate determination allowing a real appreciation in the external value of Turkish Lira. By keeping the rate of currency depreciation below the rate of inflation, it was aimed to break the vicious circle between the two variables with the objective of bringing the current inflation rate and inflationary expectations to lower levels.

Whilst the nominal anchor policy may have had some limited degree of success in checking the inflation rate through cost (supply) side effects, it could not prevent the monetary consequences of high real positive interest rates, mainly caused by fiscal indiscipline and public sector imbalances under perfect international capital mobility. The Turkish experience with "nominal archor" has shown that, employing the exchange rate as a nominal anchor, per se, is not sufficient in fighting with high inflation in the existance of some basic imbalances in the economy and under perfect mobility of capital funds. A recent study by the International Monetary Fund a proponent of "nominal anchor" policy, also reveals that whilst in the ideal case the exchange rate may be employed as a "nominal anchor" in slowing inflation rate, the reality often proves to be the opposite. The success of employing the exchange rate as a nominal anchor crucially depends on its implementation as an integral part of a consistent long-term stabilization program.

The declining trend of short-term market interest rates since the begining of 1996 has been mainly due to Central Bank's policy to keep the markets liquid. The potentially destabilizing effect of high liquidity on the foreign exchange market is checked by the Central Bank though small-scale interventions to the exchange rate.

In 1995, the banknotes issue increased by 86.3 percent as compared to 90.5 percent in the previous year. The rate of increase in the banknote issue has been considerably slower in the first 4 months of 1996 as compared to the corresponding period in the previous year; the banknote issue increased by around 27 percent in the first four months as against 68.5 percent in the previous year. The rate of growth of reserve money was around 24 percent in the first four months of the current year, as against 61 percent in the previous year.

TABLE: 20 THE MONEY SUPPLY

	BILLION TL			JAN-MAY PERCENTAGE CHANGE		PERCENTAGE CHANGE
	MAY 3	DEC 29	DEC 30			
	1996	1995	1994	1996	1995	1995
BANKNOTES ISSUED	285,346	223,934	120,212	27.4	68.5	86.3
CURRENCY IN CIRCULATION	255,210	189,542	104,370	34.6	65.9	81.6
SIGHT SAVINGS DEPOSITS	103,352	86,874	56,980	19.0	9.2	52.4
SIGHT COMMERCIAL DEPOSITS	122,145	119,581	77,450	2.1	-7.9	54.4
DEPOSITS WITH CB	98	50	181	96.0	0.6	-72.3
M1 MONEY SUPPLY	480,850	396,047	238,981	21.4	28.4	65.7
TIME SAVINGS DEPOSITS	1,046,486	789,608	372,701	32.5	47.4	111.8
TIME COMMERCIAL DEPOSITS	75,584	77,860	26,189	-2.9	18.4	197.3
CDS	7,975	6,908	4,619	15.4	54.7	49.5
M2 MONEY SUPPLY	1,610,850	1,270,423	642,490	26.8	39.2	97.7
FOREIGN CURRENCY DEPOSITS OF DOMESTIC ORIGIN	1,577,478	1,355,094	628,711	16.4	19.1	115.5
M2 MONEY SUPPLY (NEW DEFINITION)	3,188,328	2,625,517	1,271,201	21.4	29.3	106.5

The M1 money supply (narrow definition) which had grown by around 66 percent in 1995, expanded by around 21 percent in the first four months of 1996. The broad definition of money supply (M2), on the other hand, expanded by around 27 percent in the first four months as compared to 39 percent in the corresponding period of the previous year. The money creation multiplier followed a stable trend during the first four months of 1996. The income velocity of money was also stable during 1995, indicating to a relatively stable demand for money since the financial crisis during the first half of 1994.

The monetary expansion (expressed in nominal terms) during the first four months of 1996, whilst being at a relatively lower rate as compared to the previous year, appears to validate an inflation rate of not lower than 80 percent for the year.

II. COMMERCIAL BANK DEPOSITS

The currency substitution process in favour of local currency, resultant from high Turkish lira interest rates and slower depreciation of the external value of the local currency, seemed to have reversed to a certain extent since the last quarter of 1995.

Total consolidated commercial bank deposits grew by 100 percent in 1995, indicating to a real growth in bank deposits. Saving deposits increased by around 103 percent, resul-

TABLE: 21 TOTAL BANK TL DEPOSITS

	BILLION TL			PERCENTAGE CHANGE JANUARY-MAY [3]		
	MAY 1996[3]	DEC 1995	DEC 1994	1996	1995	1995
I. SAVINGS DEPOSITS	1,186,334	883,390	434,300	34.3	44.9	103.4
(a) Time [1]	1,093,856	796,516	377,320	37.3	48.8	111.0
(b) Sight	92,478	86,874	56,980	6.5	9.1	52.5
II. COMMERCIAL DEPOSITS	190,997	197,441	103,639	-3.3	-3.1	90.5
(a) Time	78,975	77,860	26,189	1.4	21.0	197.3
(b) Sight	112,022	119,581	77,450	-6.3	-11.3	54.3
III. PUBLIC DEPOSITS	97,175	38,924	19,560	149.7	18.8	98.9
(a) Time	5,984	3,486	1,592	71.7	19.1	118.9
(b) Sight	91,191	35,438	17,968	157.3	18.7	97.2
TOTAL BANK DEPOSITS [2]	1,474,506	1,119,755	557,499	31.7	35.1	100.8

(1) Inclusive of Certificates of Deposits
(2) Exclusive of interbank deposits
(3) as of May 10

tant from 110 percent increase in time savings deposits and 52.5 percent increase in sight deposits. Commercial deposits, on the other hand, grew by around 90 percent, whilst the growth in public deposits was nearly 100 percent.

Foreign currency deposits grew by around 35 percent in US Dollar terms, resultant from 35 percent increase in foreign currency deposits of domestic origin and 30 percent increase in foreign currency deposits of foreign origin. The share of foreign currency deposits in total bank deposits remained around 50 percent, indicating to the relatively strong preference of financial savings towards foreign currency.

Total TL deposits displayed a slightly lower rate of growth (32 percent) in the first four and a half months of 1996 as compared to the corresponding period of the previous year. Savings deposits grew by 35 percent in the same period of 1996 as against 45 percent in the corresponding period of 1995, whilst there was a slight decline in commercial deposits. Given that the wholesale prices increased by around 40 percent in the first five months, this meant some decline in real bank deposits in the current year.

TABLE: 22 FOREIGN CURRENCY DEPOSITS WITH COMMERCIAL BANKS

	MILLION US DOLLARS TL			PERCENTAGE CHANGE	
	MAY (1) 1996	DEC 1995	DEC 1994	JANUARY-MAY(3) 1996	1995
FOREIGN CURRENCY DEPOSITS OF:					
(a) Domestic Origin	21,221	22,195	16,365	-4.4	35.6
(b) Foreign Origin	3,365	3,397	2,611	-0.9	30.1
TOTAL F/C DEPOSITS	24,586	25,592	18,976	-3.9	34.8

(1) As of May 10

A comparison of the relative yields of some major financial savings insruments indicates that government borrowing instruments (Treasury bills and government bonds) still continue to yield the highest nominal and real returns available in the domestic financial markets Whilst a three-month commercial bank deposit account yielded a nominal return of 27.9 percent and 0.3 percent real return (adjusted for the SIS's consumer price index) in the first four months of 1996, the return yielded by the short-term (3-month) Treasury bills was as high as 46.9 percent in nominal and 15.2 percent in real terms. The return yielded by Treasury-bills for the last one year (to April 1996) was 120 percent in nominal and 21.9 percent in real terms, the highest return in the financial markets.

TABLE: 23 RELATIVE YIELDS OF SOME FINANCIAL SAVINGS INTRUMENTS
(Percentage)

	JANUARY-APRIL 1996		APRIL1996-APRIL 1995 (LAST ONE YEAR)	
	NOMINAL	REAL(1)	NOMINAL	REAL(1)
COMMERCIAL BANK DEPOSITS				
3-month	27.9	0.3	89.8	4.9
6-month	27.8	0.2	84.0	1.8
One-year	29.0	1.1	85.4	2.5
FOREIGN EXCHANGE(2)				
US DOLLAR	24.8	-2.1	75.4	-2.9
D. MARK	16.7	-8.5	58.4	-12.4
J. YEN	20.9	-5.1	38.5	-23.4
GOLD	20.1	-5.8	76.1	-2.6
TREASURY-BILLS				
3-month	46.9	15.2	120.4	21.9
6-month	-	-	116.6	19.8
GOVERNMENT BONDS	-	-	99.4	10.2
ISTANBUL STOCK EXCHANGE(3)	61.7	26.8	38.8	-23.2

(1) Nominal yields deflated by the change in SIS's Consumer Price Index.
(2) Rate of depreciation of Turkish Lira against foreign currencies.
(3) Rate of change in the Composite Index

III. CREDIT STOCK

Resultant from accelerated macro-economic activity in 1995, credits extended by the commercial banks displayed a considerably high real growth. Commercial banks short-term credits extended to the business sector grew by around 150 percent in nominal terms, resultant from 161 percent increase in TL-denominated credits and 132 percent increase in foreign currency denominated credits. Largely as a result of various uncerta-inties and somewhat negative business expectations as to the near future course of the economy, the demand for commercial bank credits was relatively lower in the first half of 1996. Credits extended by the commercial banks grew by around 32 percent (as against 36 percent in the previous year), indicating to no real growth in commercial bank credits.

Credits extended by the investment and development banks grew by around 62 percent in 1995, whilst the growth in such credits was around 40 percent in the first four and a

TABLE 24: CREDIT STOCK

	BILLION TL			PERCENTAGE CHANGE JANUARY-MAY[1]		
	1996[1]	DEC 199	DEC 1994	1996	1995	1995
I. DEPOSIT BANKS' CREDITS	1,717,888	1,297,004	518,908	32.5	35.8	150.0
(a) TL-denominated	1,007,993	813,571	310,734	23.9	38.6	161.8
(b) F/C denominated	709,895	483,433	208,174	46.8	31.7	132.2
II. INVESTMENT AND DEVELOPMENT BANKS' CREDITS	107,762	77,110	47,480	39.8	14.7	62.4
III. CENTRAL BANK DIRECT CREDITS	254,163	193,877	148,108	31.1	33.3	30.9
TOTAL CREDIT STOCK	2,079,813	1,567,991	714,496	32.6	33.9	119.4

(1) As of May 10

half months of the year (as against 15 percent in the same period of the previous year).

Resultant mainly from the relatively successful control of Central Bank's advances to the public sector (particularly in the form of short-term advances to the Treasury), Central Bank direct credits grew at a considerably slower rate, by around 31 percent, in 1995. The Central Bank seems to follow a somewhat looser credit policy towards the public sector in the first half of 1996; as a result, direct credits extended by the Central Bank grew by around 30 percent in only first four and a half months of the current year.

The growth in total credit stock was around 33 percent in the first four and a half months of 1996, being the same as compared to the corresponding period of the previous year.

IV. CAPITAL MARKET

In 1995, the local capital markets were influenced both by the heavy public domestic borrowing requirement and the political uncertainties. As a result, the considerably sharp rise of the İstanbul Stock Exchange (ISE) observed in the first half of the year was short-lived and was reversed in the latter half of the year. As a matter of fact, ISE composite index which rose by around 85 percent in the first six months of the year followed a fluctuating trend in the second half of the year, rising only by around 47 percent for the whole year, well below the annual inflation rate. In other words, the Istanbul Stock Exchange could not achieve the widely expected sharp rise both in the index and in trading volume. The composite index displayed a 47 percent rise in the year 1995, resultant from 30.6 percent rise in the financial index and 51.7 percent rise in the industrial index; the industrial index was observed to perform better than the financial index. Given the 58 percent currency depreciation (TL against US Dollar), this meant that the Stock Exchange yielded a negative return for its investors.

The larger-than-expected public budget deficit (exceeding the revised deficit target by around TL 100 trillion) and the rapidly growing domestic debt stock resulted in heavier reliance of the public sector on domestic funds market. The share of public sector stocks (mainly T-bills and government bonds) stood at around 80 percent by February 1996, whilst the share of private sector stocks remained by around 20 percent of the total stocks.

The ISE's composite index rose from 40,024 at the end of 1995, to 62,310 by 6th June 1996, marking a 55.7 percent increase in the first five months. The industrial and financial indices rose by around 50 percent and 76 percent, respectively, in the same period. It appears that, the Istanbul Stock Exchange was again unable to show the expected sharp rise in the first half of 1996.

TABLE: 25 STOCKS (BILLION TL)

	1996 (FEBRUARY)	1995	1994
PRIVATE SECTOR STOCKS	288,534	295,453	130,881
-Share Certificates	234,987	223,804	109,239
-Bonds	2,,683	2,354	1,412
-Commercial Papers	1,533	1,533	213
-Asset Backed Borrowing	48,355	66,785	19,950
-Bank Bonds	961	961	53
-Profit/Loss Sharing Certificates	15	15	15
PUBLIC SECTOR STOCKS	1,190,138	1,202,333	597,915
-Gov't Bonds	511,769	511,769	232,825
-Treasury Bills	631,298	631,298	304,230
-Revenue-Sharing Certificates	12,419	12,419	20,380
-Foreign Currency Indexed Bonds	8,022	21,847	40,480
-Privatization Bonds	26,631	25.000	-
TOTAL	1.,478,672	1,497,786	728,796

TABLE: 26 THE ISTANBUL STOCK EXCHANGE INDEX

	5 JUNE 1996	29 DEC 1995	28 DEC 1994
THE COMPOSITE INDEX	62,310	40,024	27,337
THE INDUSTRIAL INDEX	69,475	46,247	31,670
THE FINANCIAL INDEX	52,846	30,003	22,788

V. INTEREST RATES

In 1995, the market interest rates continued to be determined to a great extent by borrowing requirements of the public sector. There was, however, some decline in average market interest rates during the year. Since the beginning of 1996, as a result of the Central Bank's policy to keep the markets liquid, the overnight interbank money market rates declined to 45-60 percent from the previous 80 percent and above. However, despite the declining trend of interest rates since last year, the growing domestic debt stock and its financing mainly from the local market, shall determine the future course of interest rates during the remaining part of the year.

TABLE: 27 DOMESTIC INTEREST RATES (Percentage)

	INTEREST RATE PAYABLE ON		BANK DEPOSIT INTEREST RATE(1)	
YEARS	6-month T-bills	One-Year Government Bonds	6-month	One-Year
1990	55.10	58.90	52.0	59.40
1991	71.82	72.99	64.82	72.70
1992	75.56	77.83	69.50	74.20
1993	73.50(1)	89.23	69.10	74.80
1994	106.42	139.0(1)	81.09	95.56
1995	97.0(1)	108.0(1)	84.37	92.32

(1) Annual, simple average. Others are year-end rates
SOURCE: The Central Bank

CHAPTER 4

PRICES AND INFLATION

I. THE GENERAL PRICE LEVEL

The 1995 Economic Programme targeted an average inflation rate of 70 percent for the year, with the resultant deceleration in the annual (December-on-December) rate of inflation down to 40 percent by the end of the year. Amongst the anti-inflationary policies of the programme, were tight monetary policy and the control of inessential public expenditures.

Monetary factors have been a major determinant in explaining high and variable in Turkey, implying that any attempt aimed at controlling and reducing the current rate of inflation, must necessarily take into account the monetary implications of the policies implemented. In 1995, whilst the Central Bank was relatively successful in controlling domestic credit expansion (and thus the net domestic assets), it could not achieve the degree of monetary control consistent with lower rates of monetary expansion (and thus a lower rate of inflation). Substantial rise in net international reserves, mainly resultant from large influx of short-term foreign capital funds in response to considerable interest rate differentials, left the monetary authorities with difficult policy options of (a) either allowing the local currency become substantially overvalued, or, (b) letting a higher rate of monetary expansion through large-scale interventions in the foreign exchange market. Whilst the monetary authorities seem to have chosen a "middle -of-the-road" course of action, expansionary effect on monetary growth of the rise in international reserves could not be avoided. Consequently; changes in international reserves have become a major determinant of monetary expansion, thereby restricting the ability of monetary authorities in fighting with high inflation. The slower depreciation of the exchange rate (resultant from "nominal anchor" approach in exchange rate determination) on the other hand, seems to have eased inflationary pressures to some extent through increased importation (and thus the increase in domestic supply of goods). Yet another reason for the relative deceleration in the annual rate of inflation during 1995, was the suppressed public prices especially during the last quarter of the year, as a result of "election economics".

TABLE: 28 ANNUAL RATE OF INFLATION (Annual Percentage Change)

	CONSUMER PRICES	WHOLESALE PRICES
DEC 1993	71.1	60.3
DEC 1994	125.5	149.6
DEC 1995	76.0	65.6
1996		
JAN	78.1	64.9
FEB	77.5	63.0
MARCH	79.3	65.3
APRIL	80.8	69.9
MAY	82.9	73.7
JUNE	82.9	76.2

SOURCE: SIS

According to price indices published by the State Institute of Statistics, the annual inflation rate as measured by the Consumer Price Index, decelerated from 125.5 percent at the end of 1994, to 76 percent by December 1995. Similarly, the annual rate of change in the Wholesale Price Index, fell from 149.6 percent at the end of 1994 to as low as 65.6 percent by end-1995.

The average annual rates of change in consumer and wholesale prices, which also take into account seasonal factors in the movement of prices, were 93.6 percent and 88.5 percent, respectively. Contrary to the previous year, in 1995, consumer prices were observed to have risen at a faster rate than wholesale prices mainly resultant from lagged adjustment of the former under sluggish demand conditions of the previous (crisis) year. In 1995, demand-side factors have played a relatively greater role than supply-side (cost) factors in determining inflation.

However, the decelerating trend of inflation during 1995 seems to have reversed since

TABLE: 29 MONTHLY PRICE CHANGES (Percentage Change)

	Wholesale Prices		Consumer Prices	
	1996	1995	1996	1995
JAN	9.8	10.2	8.3	7.0
FEB	5.8	7.1	4.5	4.9
MARCH	7.0	5.5	5.6	4.5
APR	8.1	5.1	6.7	5.8
MAY	4.1	1.8	4.5	3.3
JUNE	2.7	1.3	2.5	2.6
JULY	2.3			3.1
AUG.		2.3		4.3
SEPT		4.6		7.7
OCT		3.7		6.3
NOV		3.5		4.7
DEC		4.3		3.8
FIRST SIX MONTHS	43.7	33.4	36.7	28.3
ANNUAL RATE OF CHANGE(1)	76.2	78.1	82.9	80.7
AVERAGE ANNUAL RATE OF CHANGE(2)	70.3	88.5	80.8	93.6

(1) As of end of June
(2) As of end of May

the beginning of 1996, and both consumer and wholesale prices have been on a consistently rising trend since the first month of the current year. The accelerating trend of inflation can be seen clearly from high monthly price increases. Wholesale prices rose by 43.7 percent in the first six months of the year (35.1 percent in the same period of 1995), thereby bringing the annual rate of inflation up to 76.2 percent (from 65.6 percent at the end of 1995). A similar trend was observed also in consumer prices; consumer prices rose by 36.7 percent in the first six months (31.6 percent in the same period of 1995) with the resultant rise in annual rate of inflation from 76 percent at the end of 1995, to 82.9 percent in the first six months.

In the absence of a new stabilization programme (not yet been introduced as of mid-June), the government's rather unrealistic inflation target for the year shall certainly be surpassed by a substantial margin. The annual inflation rate is highly likely to stay within 80-85 percent, implying a 100 percent deviation from the official target.

II. PUBLIC AND PRIVATE PRICES

In 1995, public and private sector prices changed at differing rates. The prices of public goods and services rose at an average annual rate of 77 percent in 1995, as opposed to 112.5 percent in the previous year. Private sector prices, on the other hand, rose at a higher rate by 93.4 percent, as against 119.9 percent in 1994. The lower rate of increase in public prices (the rate of increase in public prices was lower by around 15 percentage points, as compared to private sector prices) stemmed mainly from the suppression of public sector prices in the last quarter of 1995 due to general elections.

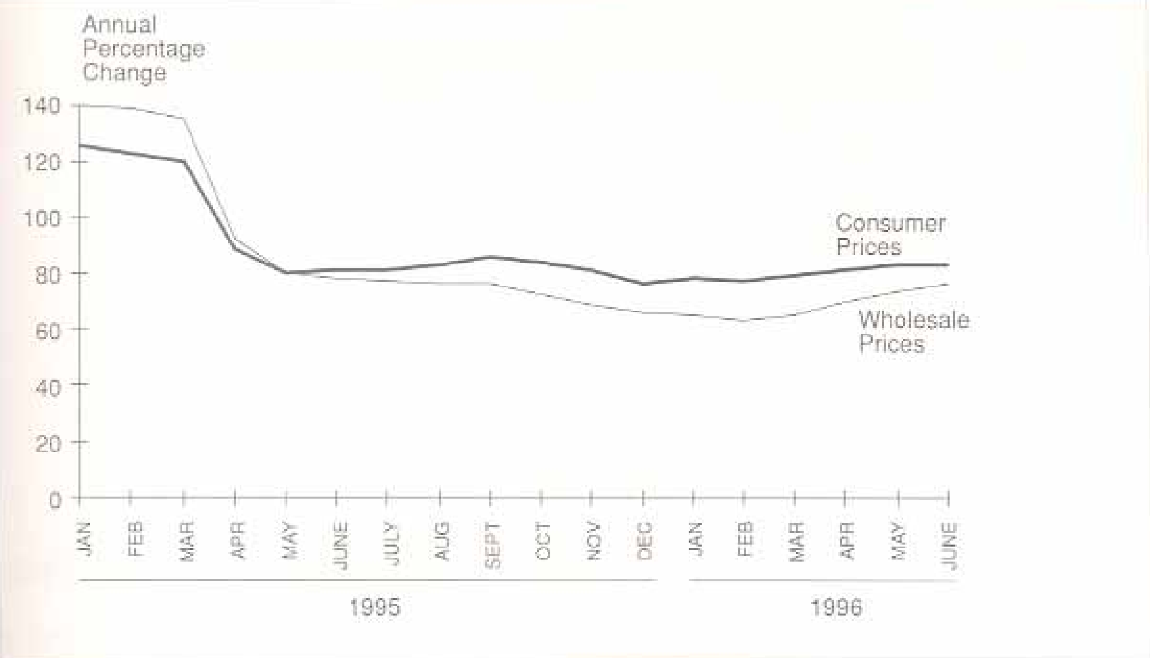
TABLE: 30 PUBLIC AND PRIVATE PRICE CHANGES(1) (Percentage Change)

	ANNUAL RATE OF FIRST FIVE MONTHS		CHANGE AS OF MAY 1996
	1996	1995	
PUBLIC PRICES	50.0	24.0	76.9
PRIVATE PRICES	37.2	28.4	72.8
OVERALL	39.9	33.4	73.7

(1) Percentage Change in the SISs Wholesale Price Index (1995= 100)

Largely as a result of lagged price adjustment in the public sector, the prices of public goods/services rose at a substantially higher rate by 50 percent in the first five months of 1996, thereby raising the annual rate of change in prices to 76.9 percent. Private sector prices rose at a lower rate than public prices by around 37 percent, partly as a result of private sector's inability in shifting the rising input costs onto final prices under weak demand conditions. Private sector prices can be expected to rise at a faster rate in the second half of the year as the lagged adjustment of final prices to rising costs takes place.

GRAPH: ANNUAL RATE OF INFLATION



	Anual Percentage Change			Annual Percentage Change	
1995	Consumer Prices	Wholesale Prices	1996	Consumer Prices	Wholesale Prices
JAN	125.8	139.7	JAN	78.1	64.9
FEB	122.6	138.3	FEB	77.5	63.0
MAR	119.6	135.1	MAR	79.3	65.3
APR	88.4	92.3	APR	80.8	69.9
MAY	79.8	80.6	MAY	82.9	73.7
JUNE	80.9	78.1	JUNE	82.9	76.2
JULY	80.8	77.7			
AUG	83.4	76.2			
SEPT	86.0	76.5			
OCT	84.3	72.4			
NOV	81.5	68.8			
DEC	76.0	65.6			

CHAPTER 5

FOREIGN ECONOMIC RELATIONS

I. BALANCE OF PAYMENTS

In 1995, the higher-than-projected GNP growth and overvaluation of the Turkish Lira resulted in widening of trade deficit whilst not causing a major problem in the balance of payments.

(a) Trade Account

In 1994, resultant from rapid depreciation of the external value of TL together with considerable decline in GNP, there was a considerable fall in the trade deficit with the current account yielding some 2.6 billion US Dollars of surplus.

In 1995, total imports increased by around 55 percent, amounting to 35,187 million US Dollars; this has meant a substantial deviation from the target (i.e. 26,370 million US Dollars). Exports, on the other hand, displayed a slower growth by around 19.5 percent, reaching to 21,975 million US Dollars. The relatively slower growth of exports was mainly due to revitalized domestic demand following the crisis conditions of the previous year and the overvaluation of the Turkish Lira by around 10 to15 percent.

As a result; the trade deficit which had fallen to as low as 4,216 million US Dollars in the previous year, recorded a sharp rise in 1995 reaching to its 1993 level. The trade deficit was up by around 213 percent in 1995, standing at 13,212 million US Dollars.

The 1996 Programme projects a 15 percent growth in imports and a 15.6 percent growth in exports, resulting in a trade deficit of 15,100 million US Dollars.

TABLE: 31 BALANCE OF PAYMENTS (MILLION US DOLLARS)

	1996 (2)	1995 (1)	1994
I. CURRENT ACCOUNT BALANCE	-3,800	-2,339	2,631
a) Trade Balance	-15,100	-13,212	-4,216
Exports (FOB)	25,400	21,975	18,390
Imports (FOB)	-40,500	-35,187	-22,606
b) Invisibles Balance	7,150	6,377	3,755
Tourism Revenues (net)			
Interest Payment (net)			
c) Unrequited Transfer	4,150	4,496	3,092
Workers' Remittances	3,380	3,327	2,627
Official Transfer (net)	770	1,071	383
II. CAPITAL ACCOUNT BALANCE	6,300	4,722	-4,194
Foreign Capital	1,200	772	559
Portfolio Investment	3,180	1,724	1,158
Long-Term Capital	300	-79	-784
Short-Term Capital	1,620	2,305	-5,127
III. NET ERRORS AND OMMISSIONS	-	2,275	1,769
IV. RESERVE MOVEMENTS	-2,500	-4,658	-206
IMF	-	347	340
Official Reserves	-2,500	-5,005	-546

(1) Provisional
(2) Projected

Accordingly; total imports and exports would reach to 40,500 million and 25,400 million US Dollars, respectively.

It appears that the first round effect of joining the Customs Union has been a deterioration in the trade account, given the slower-than-expected growth in exports. The Turkish exports grew by around 14 percent in the first quarter of 1996 as compared to the corresponding period of the previous year reaching to around 5.4 billion US Dollars. Imports on the other hand grew at a considerably fast rate, by around 36 percent, totalling 9.5 billion US Dollars in the first three months of the current year. Accordingly, the trade deficit ammounted to 4.1 billion US Dollars, whilst the current account yielded a deficit of 1.4 billion US Dollars.

The government, very recently, had to impose a 6% Fund restriction on imports in mid-July because in the first six months exports were forecast to stagnate at 10.9 billion dollars while imports were to jump to around 20.5 billion dollars with an enormous trade deficit of 10.6 billion dollars.

(b) Invisibles Account

In 1995, the invisibles account yielded a 6,377 million US Dollars surplus, meaning a 70 percent increase over the previous year. The 1996 Programme expects a further improvement in the invisibles account, whereby the surplus in this account is projected to reach to around 7,150 million US Dollars. Tourism revenues are expected to rise substantially during the current year.

(c) Unrequited Transfer

The unrequited transfers, consisting mainly of workers' remittances from abroad, displayed a further improvement in 1995, resulting in a surplus of around 4.5 billion US Dollars.

(d) Current Account

The 1995 Programme had projected a current account surplus of 430 million US Dollars. As a matter of fact, the current account yielded a surplus of 440 million US Dollars in the first quarter of 1995, but this surplus was largely as a result of the grants received from the Gulf Fund. Parallel to the widening of the trade deficit in 1995, the current account also yielded a deficit which was no lower than 2.3 billion US Dollars. The relative deterioration in the current account did not however lead to any major difficulty in the balance of payments, thanks to substantial improvement in the capital account.

The current account yielded a deficit of 1.6 billion US Dollars in the first quarter of 1996.

(e) Capital Account

The 1995 Programme had projected a substantial improvement in the capital account over the previous year, with an expected surplus of around 4.7 billion US Dollars in this account. Mainly as a result of short-term foreign capital inflow in response to substantial interest rate differential in favour of domestic interest rates, the capital account yielded a surplus of 4.7 billion US Dollars in 1995, which means a marked improvement over the previous year's 4.1 billion US Dollars of deficit. The substantial improvement in the capital account was able to offset the deterioration in the trade account, preventing any potential foreign exchange crisis stemming from the balance of payments.

The 1996 Program expects a further improvement in the capital account, whereby this account would yield a surplus of 6.3 billion US Dollars for the current year. The further improvement in the capital account is expected to stem mainly from increased portfolio investment and partly from short-term capital inflow. As of mid-1996 there exists no official disclosure about the balance of payments, but short term foreign capital funds-is still believed to play a major role in financing the current account deficit.

(f) Official Net Reserves

In 1995, the official net reserves increased by around 4.6 billion US Dollars, marking a further improvement over the previous year. The 1996 programme expects a 2.5 billion US Dollars increase in official net reserves.

II. INTERNATIONAL RESERVES

The Central Bank foreign exchange reserves which stood at around 7.1 billion US Dollars at the end of 1994, showed a rapid rise in 1995 reaching to around 12.4 billion US Dollars by the year-end. The rise in Central Bank foreign reserves continued into the first half of 1996, the reserves rising to as high as 14.1 billion US Dollars at the beginning of April. Foreign reserves held by the commercial banks, standing at 7.9 billion US Dollars at the end of the previous years, showed a 27 percent rise in 1995 reaching to 10,169 million US Dollars. Foreign exchange reserves held by the commercial banks seems to have shown some decline in the first half of 1996, which suggests that the commercial banks continue to increase their short position in foreign currency in order to profit from still high interest rate differential between domestic and foreign interest rates.

TABLE: 32 INTERNATIONAL RESERVES (MILLION US DOLLARS)

	CENTRAL BANK (OFFICIAL)			
	GOLD	FOREIGN EXCHANGE	COMMERCIAL BANKS	TOTAL INTERNATIONAL RESERVES
DEC 1994	1,410	7,112	7,997	16,519
1995				
MARCH	1,400	11,292	7,331	20,024
JUNE	1,383	13,350	7,098	21,830
SEPT	1,383	16,174	7,964	25,522
DEC	1,383	12,391	10,169	23,942
1996				
JAN	1,383	13,609	9,535	24,528
FEB	1,383	14,407	8,906	24,696
MARCH	1,383	13,915	9,173	24,471
APR 5	1,383	14,131	9,173	24,687

III. EXTERNAL DEBTS

The 1995 Programme expected a further decline in foreign indebtedness and this was expected to be achieved mainly by reducing medium and long-term debts. According to official projections, total external debt was expected to decline to 62.7 billion US Dollars through a total debt servicing of 12,240 million US Dollars.

Turkey's total external debt stock has recorded an 11.7 percent increase in 1995, reaching to around 73.3 billion US Dollars by the year-end. The rise in external debt stock, expressed in US Dollars, was partly due to the depreciation of US Dollars against DM and Japanese Yen.

TABLE 33: TERM STRUCTURE OF EXTERNAL DEBT STOCK (MILLION US DOLLARS)

	1995(1)	1994	YEARLY CHANGE
I. SHORT-TERM DEBTS	15,701	11,310	4,391
II. MEDIUM AND LONG TERM DEBTS	57,577	54,291	3,286
(a) Public	49,958	48,147	1,811
(b) Private	7,619	6,144	1,475
I+II TOTAL DEBT STOCK	73,278	65,601	7,677

(1) Provisional

TABLE 34: VARIOUS INDICATORS OF EXTERNAL DEBTS (MILLION US DOLLARS)

	1995(1)	1994
EXTERNAL DEBT SERVICE	11,897	6,993
a) Principal	7,594	6,070
b) Interest Payment	4,303	3,923
GROSS NATIONAL PRODUCT (GNP)	165,514	131,407
EXPORT REVENUES	21,975	18,390
EXTERNAL DEBT STOCK/EXPORTS(%)	333.5	356.7
EXTERNAL DEBT STOCK/GNP (%)	44.3	49.9
DEBT SERVICE/EXPORTS (%)	54.1	54.3
DEBT SERVICE/FOREIGN EXCHANGE REVENUES (%)	27.9	30.1
INTEREST PAYMENT/EXPORTS (%)	19.6	21.3

(1) Provisional

In 1995, short term foreign debts have risen by around 4.4 billion US Dollars, whilst the rise in medium and long term debts was 3.3 billion US Dollars.

Various indicators of external debts suggest that in 1995, there was a relative improvement in Turkey's foreign indebtedness. The ratio of external debt service to foreign exchange revenues declined from 30.1 percent in 1994, to 27.9 percent in 1995, whilst the ratio of external debt to GNP declined to 44.3 percent in 1995, from 49.9 percent in 1994. There was a relative improvement in the ratio of external debt stock to exports, falling from 356.7 percent in 1994 to 333.5 percent in 1995.

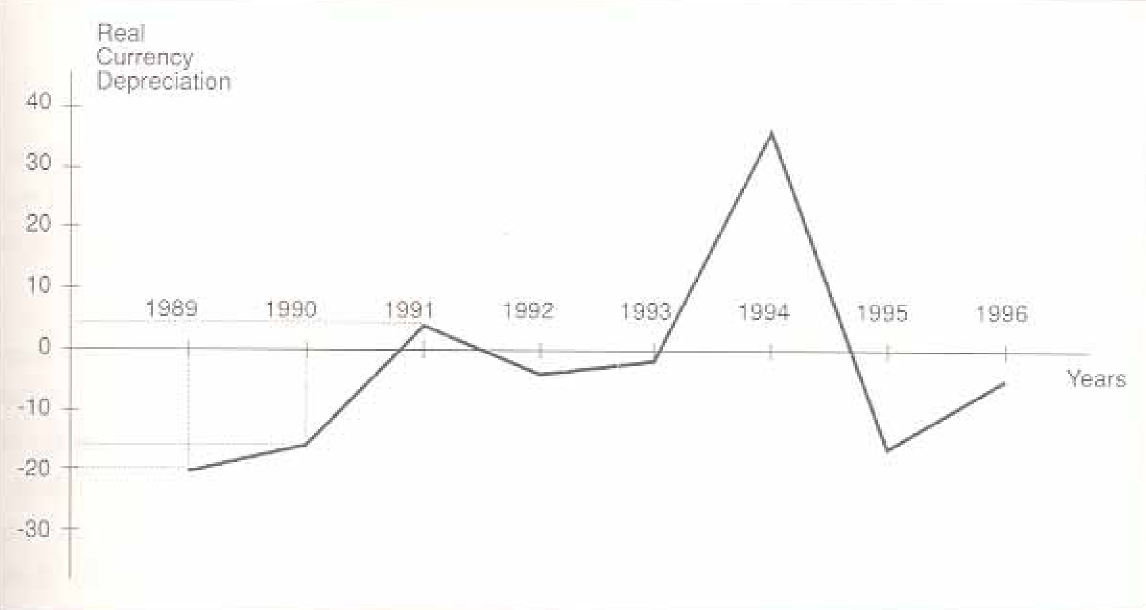
IV. FOREIGN EXCHANGE RATES

Whilst the 1995 Economic Programme envisaged a "realistic" exchange rate policy in order to achieve a high growth in exports, there was a real appreciation in the Turkish Lira with the resultant deterioration in the trade account. In 1995, the nominal depreciation of the Turkish lira against the currency basket of US Dollar (50 percent) and D. Mark (50 percent) was 62 percent, but given the yearly inflation rate of 93.6 percent, this meant a real appreciation of the Turkish Lira by around 16 percent. Overvaluation of the local currency continued also into first half of the current year, resulting in about 5 percent real appreciation of the Turkish Lira in the first five months of 1996. The rate of currency depreciation seemed to have accelarated during the month of June, largely as a result of political uncertainty and excessive liquidity in the economy. Given high and recently rising TL interest rates and the Central Bank's ability to effectively interfere in the foreign exchange markets, the rate of currency depreciation is generally expected not to exceed monthly inflation rates.

The actual trends followed by the exchange rate and the inflation rate since late 1980s suggest that, with the exception of 1991 and especially 1994, the Turkish policy makers have basically adopted a "nominal anchor" approach in exchange rate determination, allowing a real appreciation in the external value of the local currency. By keeping the rate of currency depreciation below the rate of inflation, it was aimed to break the vicious circle between the two variables with the objective of bringing the current inflation rate and inflationary expectations to lower levels. From the theoretical point of view, such an approach appears to be a proper and consistent course of action within the context of an economy with high import dependence and relatively high degree of openness. However, the natura of the relationship between inflation and currency depreciation may prove to be far more complex, which makes the nominal anchor policy an overly simplistic view of the world.

Monetary factors have been a major determinant in explaining high and variable inflation in Turkey, implying that any attempt aimed at controlling and reducing the current rate of inflation must necessarily take into account the monetary implications of the policies implemented. Whilst the nominal anchor policy may have had some limited degree of success in checking the inflation rate through cost (supply) side effects, it could not prevent the monetary consequences of high real positive interest rates, mainly caused by fiscal indiscipline and public sector imbalances under perfect international capital mobility. Whilst the Central Bank was relatively successful in controlling domestic credit expansion, it could not achieve the degree of monetary control consistent with lower rate of monetary expansion (and thus a lower rate of inflation).

GRAPH: REAL CURRENCY DEPRECIATION



Year	Real Currency Depreciation (Basket)
1989	-20.1
1990	-16.0
1991	3.9
1992	-3.8
1993	-1.7
1994	35.9
1995	-16.3
1996	-4.9
(First 5 months)	

TABLE: 35 INFLATION AND CURRENCY DEPRECIATION (Percentage)

YEAR	TL DEPRECIATION AGAINST US DOLLAR	TL DEPRECIATION AGAINST D. MARK	CURRENCY DEPRECIATION (BASKET)(1)	INFLATION RATE(2)	REAL CURRENCY DEPRECIATION (BASKET)
1989	27.5	33.5	30.5	63.3	-20.1
1990	26.7	42.7	34.7	60.3	-16.0
1991	73.4	71.5	72.4	66.0	3.9
1992	68.6	58.8	63.7	70.1	-3.8
1993	69.0	57.4	63.2	66.1	-1.7
1994	165.7	195.0	180.3	106.3	35.9
1995	58.0	66.0	62.0	93.6	-16.3
1996(3)	31.1	22.5	26.8	33.3	-4.9

(1) The currency basket comprising of 50 percent US Dollar and 50 percent D. Mark
(2) (December-on-December) yearly percentage change in the SIS's Consumer Price Index (1987= 100)
(3) First five months of 1996.

Substantial rise in net international reserves, mainly resultant from large influx of short-term foreign capital funds in response to considerable interest rate differentials, left the monetary authorities with difficult options in pursuing restrictive monetary policies and in controlling the money supply.

The Turkish experience with "nominal anchor" policy has shown that, employing the exchange rate as a nominal anchor perse is not sufficient in fighting with high inflation in the existance of some basic imbalances in the economy and under perfect capital mobility of funds. As a matter of fact, a recent study by the International Monetary Fund (IMF Occasional Paper No. 129) reveals that, whilst in the ideal case, the exchange rate can be employed as a nominal anchor in reducing the inflation rate, the reality often proves to be the opposite. Past experiences have shown that, in the absence of an ideal stabilization program and in the presence of indexation problem, using the exchange rate as a nominal anchor can lead to serious problems in the economy; the resultant reduced international competitiveness and deterioration in the external account ultimetely and inevitably evolve into severe financial crisis.

V. FOREIGN CAPITAL

Foreign capital licence issues declined by around 39 percent in the first half of 1996 as compared to the corresponding period of the previous year. The issues totalled 750.5 million US Dollars by June 1996 against 1,229 billion US Dollars of last June. Of the total 71 issues, 45 issues were related to services sector. In June 1996, Belgium ranked first in foreign capital licence issues (59.8 billion US Dollars) followed by England (42.3 billion US Dollars), USA (11.2 billion US Dollars) and Germany (5 billion US Dollars). It seems that contrary to what was claimed, the customs union has not let to a sharp rise in foreign capital inflows, but a sharp decline.

CHAPTER 6

HIGHLIGHTS FROM THE ECONOMIC PROGRAMME OF THE NEW COALITION GOVERNMENT

The following are the main headlines in the economic programme of the new government formed by the Welfare the Party and the True Path Party in early July '96 :

(1) Inflation

The government shall implement a serious anti-inflation programme and shall ensure stable growth with price stability

(2) Foreign Trade

All measures shall be taken in order to achieve continuous growth of exports.

(3) Taxation

Tax burden shall be distributed amongst different sections of the society in an equitab-le manner. Tax system shall be reformed in order to reduce the size of the unrecorded economy.

(4) Customs Union

Laws pertinent to the Customs Union shall be enacted without delay.

(5) Growth

The country's resources shall be mobilized more effectively in order to achieve higher GNP growth.

(6) Capital Market

The local financial markets shall become more transparent.

(7) Gold Exchange

The Gold exchange shall be improved, spot and forward markets shall be established.

(8) Financial Sector

Legal arrangements shall be made in the financial sector, with priority given to banking and insurance

(9) Foreign Capital

Liberal regulations shall be continued with respect to foreign capital

(10) Public Investment

Priority shall be given to health and education in public investments and the the elimination of regional imbalances in development.

CHAPTER 7

MÜSİAD'S RECOMMENDATIONS TO THE NEW COALITION GOVERNMENT

I- GROWTH AND PRICE STABILITY

Time and past experience have proven over and again that, it is not possible to reduce the prevailing high inflation to single digit levels through short-sighted, myopic and politically motivated policies or only through restrictive demand management policies. Turkey has been "living with high inglation" for many years, and readjustment of the economy to lower levels of inflation therefore inevitably requires implemantation of a 3-5 year transition programme in a persistent and determined manner in order to reverse the present inflation trend. A successful, sustained and enduring fight with inflation in Turkey can become possible not only through some restrictive demand management policies in the short-run (tight monetary policy, reduced public sector deficits, etc.), but also by adoption of policies and practices aimed at increased production, restored production-consumption balance and increased competition in the economy. Policies and practices must be adapted to eliminate all kinds of imperfections in the goods and factor markets in order to achieve higher production at lower cost. The government must aim at "gradually achieved price stability within some reasonable output growth-based on export and investment", rather then putting a strong break on the real economy for some short-lived gains in the inflation front.

The government must design a "**medium-term stabilization programme**" and secure a wide public consensus by persuading all sections of the society that the cost of such a programme would be distributed equitably amongst all sections. Breaking inflationary expectations which is a very crucial factor in fighting with high inflation especially in countries like Turkey experiencing high and "institutionalized" inflation for a long time depends to a great extent on the general public conviction that the government has necessary political will and determination to fight with inflation and introduces an internally consistent and realistic stabilization programme.

The foregoing suggests that, anti-inflation programme of the government must be in the nature of an **"economic restructuring"**, rather than a monetarist and restrictive authority package.

The most important factors to achieve a sustainable and stable growth are as follows:

A) Government should achieve a balance between its budgetary revenues and expenditures: For this purpose, instead of trying to match expenditures to revenues, a different approach can be adopted, i.e., "revenues matching expenditures." For the governmen to balance its revenue and expenditures:

1- Budgetary expenditures, among them, most importantly personnel, interest and investment expenditures should be taken under control.

A partisan policy of **new employment in public service** should definitely be avoided. Excessive losses of State Economic Enterprises should be eliminated through speeding up of their privatization process. In privatization, successful experience of Kardemir Inc. can be repeated for other privatizations.

2- Interest: Taking into consideration the fact that interest payments on total debt stocks constitute the biggest item on budgetary expenditures, therefore government had to pay TL 587 trillion as repayments (TL 247 trillion for internal debts, TL 340 trillion for external debts) in 1995 and also will pay about TL 1,700 trillion for debts in 1996 a **"new restructuring in debt repayments"** should be introduced and implemented. In this framework:

- A partial monetization in parallel to the imposition of a drastic tax, i.e. 50 % on bond and T-bill incomes during repayment could be put into practice;
- New external debts should be avoided to acquire while they should be aimed to be reduced.
- State should reduce investment expenditures by encouraging private sector-and foreign capital-based investments.
- Defence and security expenditures, one of the most important items of which is the expense on the South-Eastern problem should be reduced in parallel with solving that problem.

2- On the centrary **increase in budgetary revenues** should not be taken as a goal, but as a means in achieving economic equilibria. In this framework;

- A tax revenue-based taxation policy should be implemented, depending on production and employment growth;
- Savings of the Turkish nationals working abroad amounting to supposedly 80-100 billion dollars should be encouraged to grow into the country through privatization as well as investment incentives;
- Interest income stemming from T-bills, bonds and repo transactions should be imposed tax on it;
- Excessive real-estate gains should be taxed whilst annual tax on real-estate should be indexed to inflation rate, but on the basis of a much lower rate;

2- Secondly, in order to attain a sustainable and stable growth, there needs to be a major overhaul in the education field. Apart from rehabilitation of major schools, private schools and private universities should be encouraged and bureaucratic difficulties eliminated.

II- PUBLIC DOMESTIC BORROWING

Rapid growth in the public domestic debt stock mainly resultant from high interest cost (around 30 to 40 percent in US Dollar terms) has been one of the most serious problems faced by the Turkish economy. Unless radical measures are taken today in order to reverse the rapidly rising trend of domestic debt stock, it will be much more difficult to manage it in the future as the interest payment on the debt stock is highly likely to exceed total tax revenues in 2 or 3 years time. Measures and practices must be adopted towards reducing the high cost of public borrowing and extending the average (short-term) maturity structure of the existing debt stock to longer maturities.

The government must not yield to begin taxation of financial incomes, effective from the beginning of 1997.

The government must introduce rapid and radical solutions to the existing public debt problem which has dragged the economy into "inflation-exorbitantly high interest" vicious circle. For this purpose, the existing debt stock must be partially monetized, together with introduction of a 50 percent taxation of interest incomes on T-bills and government bonds which would offset the monetary growth caused by partial monetization. In doing these, the government must act rapidly and with decisiveness, not allowing speculative movements in the markets to impact the introduced measures in an adverse manner. With the objective of preventing governments from excessive borrowing largely for politically motivated unproductive purposes, constitutional limits must be imposed as to the maximum allowable amount of public borrowing.

III- RESTRUCTURING OF FOREIGN ECONOMIC RELATIONS

The government must aim at a "dual economy" model which would increase exports whilst reducing imports to the minimum possible. For this purpose, foreign economic relations of the country must be reformed; a Foreign Trade Ministry must be established and this ministry must be organized both within Turkey and abroad.

Businessmen also from the private sector must be employed at Turkey's representative offices abroad; these offices must provide legal, technical and marketing support needed by Turkish businessmen abroad.

IV- INCENTIVE MEASURES FOR INVESTMENTS AND EXPORTS

(a) Incentive Policy

The government must introduce incentive which would increase investments and industrialization in order to increase total supply of goods and services. Resultant from stagnation in productive and technological investments in recent years, the productive capacity of the Turkish economy has not been growing. With the purpose of achieving a sustainable, export-led growth, priority must be given to investments geared towards additional capacity creation and modernization.

In encouraging exports, monetary incentives which violate international trade rules must be avoided; incentives must aim at reducing the cost of production inputs and must be granted at the production level.

(b) Investment Incentive Measures:

* Corporations must be exempt from Withholding Tax in their investments made under incentive scheme.

* Tax deductibility must be raised to 200-300 percent in investments undertaken in priority sectors.
* Exemption from tax, stamp duty etc. must also be granted to investment without export commitment.
* Cash grant applicable in domestic machinery and equipment purchases must be increased from VAT + 10 percentage points, to VAT+20 percentage points.
* In order to eliminate the existing red-taping in the existing cash grant practice (VAT+10 percent), VAT must be lifted in investment goods purchase [In the existing practice, the investor first pays for the VAT, and refunds it after 6 months following a lengthy and costly legal procedure).
* Those investors who do not honour their debt towards the Tax Office, Social Security Institution and to public banks on time, must be deprieved from receiving Incentive Certificate.
* In case the credits with a grace period of 3 or 6 months are used in actual investment, interest must not be applied on such credits.
* Investments must be encouraged by an "Investment Fund" and "Venture Capital Fund". Investment Fund can be sourced from the Seniority Compensation Fund to be established.
* In view of the scarcity of local funds, measures and incentives must be introduced in order to attract savings of Turkish workers abroad, which are estimated to be no less than 10 billion US Dollars on a yearly basis.
* State lands must be allocated to investors free of charge, infrastructure (on these lands) must be built by the government. However government must ensure and get necessary guarantees so that investments on these lands must be finalized within a specified period of time.
* Investors must enjoy some kind of "exchange risk guarantee" through writing off as an expense any excess of finance cost over the inflation rate (as measured by the annual rate of change in the Wholesale Price Index)
* Bureaucratic formalities at customs and in tax offices must be reduced to a minimum for companies holding Investment Incentive Certificate.
* Lease contract period must be reduced to 3 years in the case of financial leasing companies leasing out machinery and equipment.

* Inflation Accounting must be introducted, tax policy must encourage employment of equity capital. Under the present system, incomes derived from equity (own capital funds) are subjected to full taxation, whilst interest expense on borrowed funds are tax deductible.

* Advance payment of tax should be suspended.

* Tax red-taping should be simplified with a major overhaul of hundreds of different tax practices.

* Tax on real-estate must be adjusted every year in parallel to the inflation rate; tax on real estate payable by the seller and the seller must be reduced to 1 percent from the existing 4 percent. Real profits (nominal profit adjusted for inflation) earned on sale of real estate must be subjected to taxation.

VII- PRIVATIZATION

Every effort must be exerted in order to reduce the present disproportionately large size of the public sector (around 50 percent of the economy). Privatization must be materialized rapidly subject to a certain timetable. However, **the following criteria must be observed in future privatization practices:**

* Revenues generated from privatization must be utilized mainly for productivity improvement and rationalization of production.

* While privatizing state economic enterprises, they must not be handed over to a few monopolies; rather, anti-cartel laws already enacted by the Assembly must be effectively implemented in order to establish and maintain competitive conditions in the economy. A "Competition Board" must be formed in order to establish and maintain fair competition conditions.

* Purchase offers by workers through their trade unions must be treated seriously and be given equal opportunity (a successful example is KARDEMİR)

* Privatization must not become a means of money laundering, and transparency in privatization process must be given utmost care in order to avoid any misunderstanding and mistrust in the minds of the general public.

* The share of foreign capital in the privatized state economic enterprises, except in those sectors requiring high-technology investments, must be limited to a certain percentage (as in the case of privatization practices in France and Switzerland)

* Savings of Turkish citizens working abroad should be encouraged to be channelled into privatization in the form of "share permit" instead of "car or durable goods permit" which is the case at present.

VIII- LABOUR RELATIONS

(a) Reform in Social Security Institutions:

The existing social security institutions are at the edge of bankrupcy, with the estimated deficit of as high as TL 276 trillion for the year 1996. With the purpose of overcoming severe difficulties currently faced by these institutions, the following measures are recommended:

* Retirement age must be raised to 55 for woman and 60 for men.
* Insurance premium ceiling must be raised.
* The existing three Social Security Institutions must be unified under one structure, thereby reducing the highly complicated and inefficient structures of the existing social security system.
* Collection of premiums due to Social Security Institutions must be speeded up; effective collection of revenues from the real estates (of these institutions) must be ensured.
* Private insurance corporations must be encouraged to enter into health and retirement insurance business.

(b) Reform in Minimum Wage.

* Given the unbearably high cost of living in Turkey, minimum wage must be increased with immediate effect. Accordingly; The Committee for Minimum Wage must determine the new minimum wage in July and must implement it effective from early August 1996. Within this context;
* Gross minumum wage must be increased from the existing TL 8,460,000 to TL 20 million (gross wage).
* Income tax rate on the minimum wage must be reduced from 25 percent to 10 percent.
* Stamp duty and "Fund for the Encouragement of Saving" on minimum wage income must be abolished.

* These would increase the net minumum wage to TL 15,480,000 from the existing TL 5,547,000.

* The minimum wage must be revised (adjusted) bi-annualy, in parallel to the change in SIS's consumer price index.

(c) **Establishment of "Seniority Compensation Fund"**

The existing system creates a heavy burden on the employer and leads to disputes in employer-employee relations, MÜSİAD's research report on **"Seniority Compensation Fund"** which aims at offering a solution to the problem agreeable by employers, employees and the government, shall be disclosed to the public in one or two months.

IX- FINANCIAL SECTOR

* A number of necessary arrangements and amendments in the existing legal framework must be made in order to promote growth of Special Finance Houses in Turkey ("interest-free banking institutions").

* Financial institutions should be ensured to channel financial resources saved by people to industrial and commercial activities as against today's general practice of channelling people's deposits to the state through T-bills and bonds.

* Necessary regulatory arrangements should be enacted for financial institutions to provide a certain percentage of their funds for venture-capital investments and another certain part for medium-to long-term investment credits.

* Specialisation should be encouraged in the financial sector.

* Industrial and commercial conglomerates should be prevented to enter into banking sector if they intend to channel funds for themselves.

X- CUSTOMS UNION WITH THE EUROPEAN UNION:

The Customs Union which came into fully operation on January 1 st, 1996 with the European Union has turned against Turkey. In contrast to the concentrated publicity, the results of the first 6 months are showing that the EU is getting all the advantages of the agreement. On the otherhand, Turkey is suffering from the negative results, such as anti-dumping taxes or European Union's failure in fullfiling its financial aid committments.

A- EVALUATION OF THE CUSTOMS UNION AT ITS FIRST SIX MONTHS:

* Customs Union was presented in the Turkish public as if people would have benefited from quality goods at lower-cost prices. However, on the basis of consumer price index, the annual inflation rate has risen to 82.5 % by June 30 th, 1996 which it was 78 % on December 31 st, 1995. The margin of customs duty which was removed seems to have gone into the pocket of importers and wholesalers.

* It was declared that due to the concept of globalisation, integration into the European Union was necessary whilst by means of Customs Union, the path towards membership in the European Union would have become shorter. However, ex-communist countries like Central and Eastern European countries, Baltic Countries, Slovenia, Croatia, Greek Cypriot Side and Malta were declared to be among candidate countries while Turkey, like Russia was taken into the category of "countries with which relations will be strengthened". Every 6 months the EU invites laeders of candidate countries to the European Summit, but accepts the Turkish Premier only for consultation meetings with leaders of 3 Troika countries (this concession could be taken only by Turkey's insistent demands).

* The EU, despite Turkey's continuous objections, has decided to start the membership talks with Greek Cypriots after six months upon the successful conclusion of the Intergovernmental Conference on the Maastricht Treaty.

* Due to the implementation of the Customs Union, Turkey has lost 3 billion US dollars stemming from removal of the customs duties and funds. In a period which Turkey is likely to face a budget deficit of 1,300 trillion TL, the "Special Consumption Tax" law could not have been passed in the Assembly with a view to compensating the loss of revenues.

* The committment by the EU of an amount of ECU 2.2 billions for 5 years to compensate Turkey's loss of customs duties, fund restrictions and to increase the level of competitiveness of the Turkish Industry was also another discouraging issue. Apart from the fact this amount of money was in reality extremely low, the aid of 2.2 billion ECUs that was in the form of ECUs 375 millions of grant and the rest as project credits. Till now, due to the veto by Greece, the EU has not even transferred the amount of ECU 22 millions grant and ECU 178 millions of project credits for the year of 1996.

* Even the meeting of the Association Council which was scheduled to be held on 26 March '96, had to be postponed due to the veto exerted by Greece.

* Although, it was known that it was impossible to export goods to EU without having a CE certificate, a National Accreditation Committee could not have been established yet in Turkey. Also, the organisations responsible for testing and certificating laboratories have not been set up yet.

* Even though regulations to adopt the Competition Law of the EU was enacted a long time ago, however European Union's competition regulations has been prepared, a Competition Board could not be formed to implement these regulations in practice and to examine anti-cartel practices. Also, preventing the anti-dumping applications by the EU for the Turkish goods are very important. Hence, not setting up a Competition Board is a major excuse for anti-dumping practices by the EU on Turkish industrial exports.

* There are also many uncertainties at customs as well as many difficulties in adapting to new import and export procedures. While the Undersecretariat for Customs could not announce the import-export figures for the months of 1996, the government estimates a mere 4.2 % growth in exports, but a jump of 40 % increase in imports for the first 6 months of 1996. Exports were reduced by 12 % in June only.

* The most agitating issue is that in contrast to the expectations of an enormous increase in textile and garment exports, a sharp decline has been experienced in this sector. There was only a 10 % increase in textile exports, 7 % decrease in garments and 23 % decrease in leather and leather products.

  Many reasons could be given for the decline of exports; withdrawal of incentives in the aftermath of the Customs Union; incentives in importing lower priced raw-materials from third countries had to be halted; energy costs higher than the world prices; high tax pressures on manufacturers-producers, not having any reasonable supports for small-and medium-sized enterprises; recession in the lucrative Western European market, especially in Germany and France hit the exports badly; and lastly deviation from realistic exchange-rate policy.

* Instead of accepting as a partner and a candidate for full membership, the EU has been continuing to treat Turkey as a third country. Last February the EU Commission started an investigation on Turkey's exports of "leached cotton materials". According to the provisions of the Customs Union, Turkey was supposed to stop state aids in general in 2 years and in textile industry in one year. However, since January 1 st, 1996 the EU has forbidden the Turkish government to grant any incentives in synthetic fibre industry and even for capacity expansion.

* Border-Trade regulation has been changed in accordance with the Customs Union agreement: restrictions were brought for the coverage of Border-Trade and the cities which are permitted. Border trade is one of the most important means in resolving Turkey's problems in its Eastern region. Taking into account spending trillions of Turkish Liras for the security of the region over 12 years, border-trade could help very much in solving the economic problems in the region.

* Upon the conclusion of a Free Trade Agreement in the coal and steel products, imports from the EU as from early January of this year. But the EU still imposes duties on Turkish exports of coal and steel. Also, according to the free trade agreement, Turkey will not be able to grant government incentives to long products.

* While the EU is failing to fulfill some of its committments acting against Turkey's interests, also the EU exerts pressures on Turkey to eliminate customs duties for live animal, milk powder, flower bulb etc., agricultural products which are excluded from the Customs Union.

* While Turkey's foreign relations are concentrated only on the European Union, relations and integrations in Black-Sea Economic Cooperation Zone, ECO, South - East Asian countries are becoming marginal. Also, due to the Customs Union, Turkey was forced to impose quotas on textile imports from many Islamic Countries i.e.: Pakistan, Uzbekistan, Kazakhistan, Bosnia and Herzegovina. For this reason, countries such as Hong-Kong, Philippines and Malaysia intend to take their protest against Turkey before the World Trade Organisation.

  Consequently, the implementation of the Customs Union was resulted in dismay on the Turkish side.

B- MEASURES TO BE TAKEN FOR CUSTOMS UNION:

1) Institutional and sectoral measures:

* Turkey should ask a renegotiation of the Customs Union on the topics of: bilateral trade functioning against Turkey, not freeing financial aid, anti-dumping practices on Turkish exports. Thus the EU could be forced to act according to the agreement.

* Even regardless of the Customs Union, Turkey should immediately implement and put into practice anti-cartel regulations, set up the Competition Board and enact the "Special Consumption Tax" law.

* In the case of EU's failure to comply with some of its commitments, preventive measures should be taken for Turkey's rights. A preferential treatment should be asked for machinery manufacturing, electrical investment goods, chemical products, furniture-forestry products, pulp and paper, etc..

* Exceptions to regulations on patent rights, intellectual property and trade mark should be demanded.

* Realistic exchange-rate policy could be useful. However, precautions have to be taken for preserving macro-economic stabilities. Also some standards could be imposed on agricultural imports from the EU.

* Turkey should resist to give any extra advantages for duties on agricultural imports from the EU while the latter applies restrictions on its agro-food imports in the form of non-tariff barriers.

C- MEASURES TO INCRASE THE COMPETITIVENESS OF THE TURKISH ECONOMY:

MÜSİAD proposes the immediate implementation of the following programme with the objective of strengthening the Turkish economy and enhancing its competitiveness under the Customs Union:

1- Financial Support to SMEs (Small and Medium-Sized Enterprises)

The government must provide financial support to SMEs from its own sources and sources to be obtained from the European Union.

(a) Financial Support for Investment:

Investment incentive schemes are used intensively within the European Union. Manufacturing industry received huge grants from the government, such grants amounting to 33.6 billion ECU in 1989, 44.2 billion ECU in 1990, 35.7 billion ECU in 1991, 34.1 billion ECU in 1992. In view of the stagnating investment activiy in Turkey for the past 10 years, the Turkish industry requires an investment of 9 - 10 billion Dollars every year for the next 10 years. Within this context, it is necessary to allocate around 70 percent of investment credits to SMEs and utilization of such credits must be subjected to close monitoring. Such credits must range between 250,000 US Dollars (minimum) and 2.5 millon US Dollars (maximum); 20 percent of these credits must be in the form of operating capital.

(b) Financial Support for Trade Financing:

EXIMBANK credits must be increased in order to enhance the export capacity. Turkish companies exporting to EU are in need of a 3 to 4 billion US Dollars of export financing every year. The government must financially support participation of Turkish exporters to fairs/exhibitions abroad.

2- Financial Support for Infrastructure:

Turkey is in need of huge infrastucture investments in the fields of mass transportation, energy (2.5 billon US Dollars/year), highways, ports, communication and forwarding.

3- Determination of Cost Differences

The Turkish industry utilizes energy at a very high cost when compared to the European countries. Compared on the basis of the purchasing power parity, the cost of fuel oil, natural gas and coal is the highest in Turkey amongst 20 OECD countries. According to the 1993 OECD data, the cost of one kilowatt of energy is 0.19 Dollar whilst it is only 0.15 Dollar in France, Germany and Belgium. Accordingly, energy must be provided to the Turkish industry at similar costs with the European competitors. Cost differences between Turkey and the EU countries in other production inputs must also be specified and arrangements must be made as to avail production inputs to Turkish industries at similar costs with European counterparts. Compensating taxes must be imposed on subsidized products (especially on agriculture based products) of the European Union.

4- Technology

Cash grants must be given to manufacturer-exporter companies for research and development activities. Large scale industrial companies must be encouraged to establish laboratories, whilst laboratories must be established for the common use of SMEs. Universities instead of TÜBİTAK (Scientific and Research Institute of Turkey) must be authorized for the allocation and following-up of research incentives.

5- Education/Training

An education reform must be put into effect without any delay. Education must be practice-oriented and aim at increasing total quality and qualification of teachers/students. Privatelyrun education institutions must be encouraged and necessary amendment must be made in the Constitution with regard to universities. Vocational schools must be encouraged.

6- Marketing Support

Government must support marketing activities of companies in existing and potential export markets.

7- Governmental Support

Government officials must give active support to Turkish businessmen who undertake big projects abroad.

8- Elimination of Physical Barriers

Free movement of Turkish citizens must be achieved within the European Union, visa restrictions must be eliminated.

9- Red-Taping

Red-taping of all kinds must be eliminated, thereby saving cost to a considerable extent.

10- Information

Turkish businessmen and industrialists must be informed about relations with various institutions of the European Union.

TABLE: 36 MÜSİAD'S ECONOMIC FORECASTS FOR 1996 (END OF YEAR)

	MÜSİAD FORECAST
GNP (GROWTH RATE	5.5 - 6.0 %
INFLATION RATE	80 - 85 %
EXCHANGE RATES	
TL/US DOLLAR (year-end)	110,000 TL
TL/D.MARK (year-end)	72,000 TL
EXPORTS (MILLION US DOLLARS)	24,000
IMPORTS (MILLION US DOLLARS)	42.000
TRADE DEFICIT (MILLION US DOLLARS)	18.000
CONSOLIDATED BUDGET DEFICIT (TRILLION TL)	1,000 - 1,100
PUBLIC DOMESTIC DEBT STOCK (TRILLION TL)	2,750
FOREIGN DEBT STOCK (MILLION US DOLLARS)	75,000

(1) Expenditures on the Gross Domestic Product

MÜSİAD

ISBN 975-7215-09-0